

In addition, rates that are too low relative to the supply of savings send false signals to borrowers about the health of the economy and the viability of investments. Since consumption has not really been deferred to the future (which would be the case had interest rates fallen due to market forces), capital investments intended to satisfy future consumption will be much less likely to succeed. The result is phony booms followed by spectacular busts, such as those just experienced in stocks and real estate.

CHAPTER

7

INFRASTRUCTURE AND TRADE



Traditionally islanders drew their drinking water from the mountain streams and carried it to their huts in whatever vessel they could fashion.

As a result, most people didn't live or work very far from the water supply. Poor access to water also made farming very difficult. These realities limited the island's overall productivity.

One year, a terrible drought descended and dried up many of the mountain streams. The hardship just about wiped everybody out.

The islanders searched for a solution that could prevent such a calamity in the future.



The fertile mind of Able Fisher V (Able's great-great-great-grandson) tackled the problem. He noticed that rain runoff collected in ponds. Taking his cue from nature, he devised a runoff and reservoir system where rainwater could be collected and stored for future use. But this would be a big project, furnishing the entire island with water.



As Able V conceived it, the Water Works project would require working capital of 182,500 fish...enough to support a crew of 250 men for two years while they labored. He went to Manny Fund for a loan. Manny loved the idea but he just didn't have enough fish. Fearing the worst, Able then tried the bank.



To his surprise, Maxine Goodbank (another descendant) had a receptive ear! Although the price was indeed high, when weighed against the potential rewards, the risk seemed justified. If it worked, the project would pay for itself and ensure a better future for every islander!

But no matter how much she liked the idea, Goodbank would not have been able to finance the project if the island had not saved enough to pay for it. There simply would not have been spare fish to feed 250 non-fishing workers for two years.

But upon completion, the Water Works delivered as advertised and allowed the borrowers to pay back their loan plus interest.

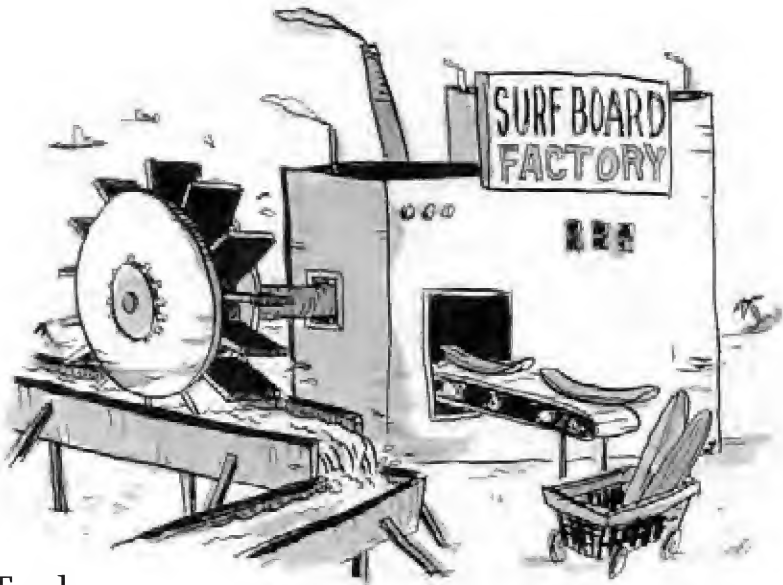


Islanders were happy to pay yearly fish fees for the running water. From these payments, Water Works employed more than 100 workers year-round to tend the system's intricate bamboo pipe system.

The splashing success of the Water Works project flowed through the island's economy. Pipelines, available for a reasonable charge, brought water great distances, and allowed previously infertile land to produce crops.

The steady flow of water could be harnessed to operate machines, giving birth to new industries.

Relieved of the task of hauling water by hand, everybody now had more time available for the production of consumer goods and services and for the development of new capital projects. The increased productivity allowed society to catch even more fish, and living standards rose as a result.



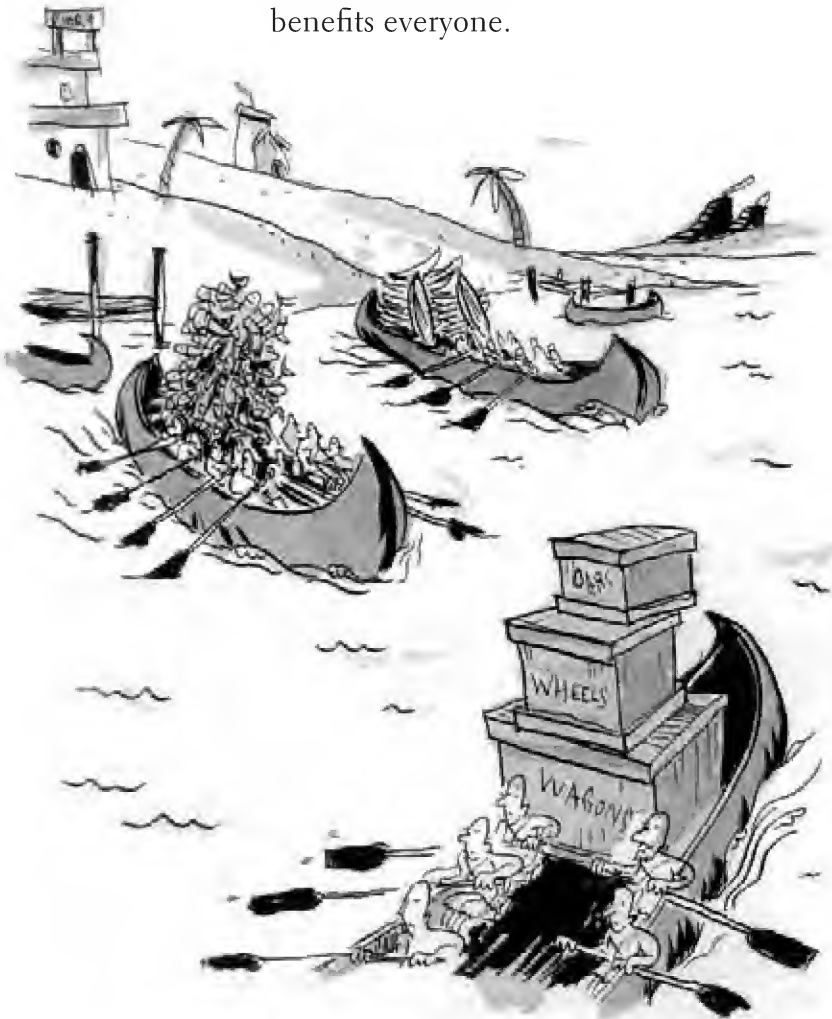
Trade

As the island economy expanded, its ability to export production abroad increased as well. Soon giant cargo canoes were sailing over the open ocean, fully loaded with fish, carts, surfboards, spears, and canoes. In exchange for

these products, which had gained an ocean wide reputation for quality and affordability, the cargo canoes returned with fresh fish and other trade goods previously unknown on the island.

As the island's explorers came into contact with other islands, trade developed that further stimulated growth.

When allowed to flourish unhindered, free trade benefits everyone.

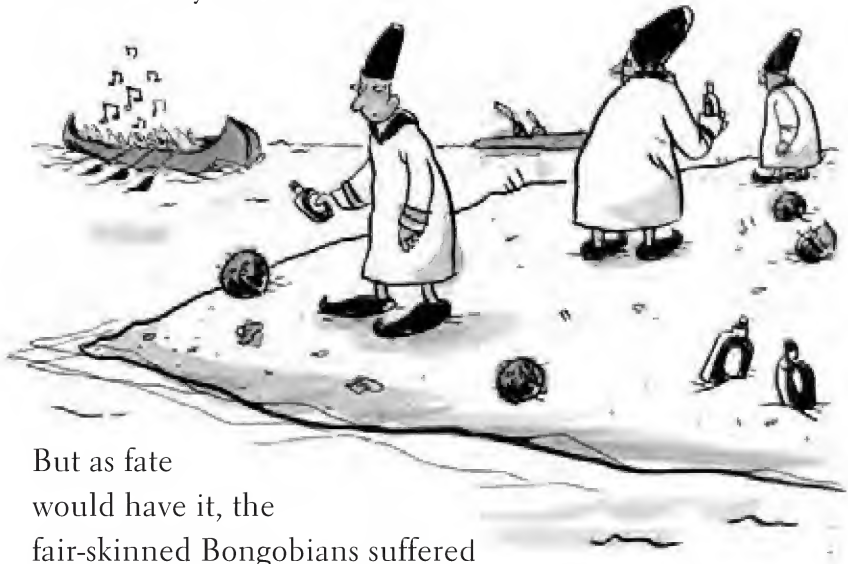


Some islands (or cities, countries, or even people for that matter) often have a relative abundance of something that others don't. Each person, country, or island will naturally use its own particular advantages to get the most reward for what it has.

For instance, the nearby island of Bongobia had a great quantity of—you guessed it—bongos. The natives had perfected the craft of bongo-making and their island was overgrown with the best trees for making bongos. As a result, there were so many bongos on the island that each individual drum was not worth much. As a domestic trade good, a pair of bongos didn't go too far.



One hundred miles from Bongobia, the island of Dervishia was populated by natives who were smitten with bongos. Unfortunately, their environment lacked the right kind of trees to make them. As a result, on Dervishia bongos were a scarce and valuable trade good. What the Devirshes did have was an abundance of coconut tanning oil. But the dark-skinned Dervishes had no need for UV protection, so tanning oil was nearly worthless to them.



But as fate would have it, the fair-skinned Bongobians suffered from chronic sunburn due to the island's unrelentingly sunny weather.

When the two islands finally made contact with one another, they instantly developed a robust trade in bongos and tanning oil. Each island used its competitive advantage to send the other island products that were more valuable overseas than they were at home. In this symbiotic arrangement, both islands benefited. Living standards rose...and well-toned drumming was achieved by all.



=



Trade on a national level is no different than labor specialization on a personal level. Each individual, or country, trades what it has in abundance, or what it does best, for the things that it doesn't have or can't easily make.

✓ REALITY CHECK: BIG vs. LITTLE ECONOMICS

Now that the island community is so much bigger than it was when there were just three guys fishing by hand, to some it may appear that the economics have changed...but have they?

Just as the principles of mathematics don't change with the size of the problem, basic economic principles do not change with the size of the economy. They're just harder to see because of the many layers that exist between savers and borrowers. But the direct relationship among self-sacrifice, savings, credit, investment, economic incentive, and social and economic progress are always the same.



TAKEAWAY

Infrastructure spending can make a huge impact on an economy. But such spending is helpful only if the benefits exceed the costs. If not, the projects waste resources and hinder growth.

Currently, many politicians and economists erroneously view infrastructure spending not as a near-term cost that may lead to long-term gain, but as an immediate means to create jobs and boost the economy. This view can lead to costly misallocations of resources and the unseen destruction of jobs in other areas.

Over the past half century the United States has vastly underinvested in infrastructure. The cost of undoing this neglect is a burden on the current economy. The payoff comes in the future, and only if the work is successful.

In our story, the 182,500 fish borrowed to build the Water Works were no longer available to fund other job-creating investments. That's a big chance to take. Had those fish instead been spent on a worthless infrastructure project, such as Alaska's famed "Bridge to Nowhere," the island's savings would have been squandered and 250 islanders would have wasted two years' labor.

For much of the early history of the United States, projects like the Water Works were often private sector initiatives. But given the inherent unpredictability about the success of these projects, in our age of nearly universal government control it seems inconceivable that such an undertaking could be funded, built, and operated

equitably by profit-driven private companies. But in those days they were.

For example, the New York City subways were largely built by private companies and were operated outside of city control for almost four decades. Despite the staggering construction costs, the railroads were able to operate at a profit. What's more, the fare never went up in 40 years.

These days, it's very easy to convince voters that large public amenities—like sewers, highways, canals, and bridges that are meant to benefit everyone—need to be run by the government. Politicians have successfully argued that private companies, which are motivated solely by profit, would exploit the public at the earliest opportunity.

The evidence supporting these claims is largely emotional. What is far more certain is that the government's monopoly control of public projects and services almost always leads to inefficiency, corruption, graft, and decay.

When a government project experiences cost overruns or poor service, free market discipline does not come to the rescue. The government simply raises taxes to fill the gap. In so doing, it wastes societal resources, and living standards drop.

Trade suffers from similar misconceptions. In their quest to protect American jobs from overseas competition, the opponents of free trade ignore the benefits of imports and the hidden costs to consumers that result from restricted choice.

For instance, if a foreign manufacturer can deliver T-shirts to the United States that sell for less than domestically produced alternatives, then Americans can spend less on T-shirts.

The money saved would be available to be spent on other things....skateboards perhaps. This would benefit the skateboard companies that may still be located in the United States and that can deliver the most valuable product in their category.

But what about the workers of the domestic T-shirt manufacturers who lose their jobs? If their employers cannot find ways to compete more effectively in the T-shirt business, it is true that the workers will have to find other work. But it is not the aim of an economy to provide jobs. The goal is simply to maximize productivity.

Society as a whole is not helped by perpetuating inefficient use of labor and capital. If the United States no longer has a competitive advantage in T-shirts, it must find something else in which it does.

If trade barriers were erected to protect those jobs, the cost of T-shirts would stay high. People would have less money to spend on skateboards (for instance), and those manufacturers would suffer. And so while it's easy to put your finger on the job that is saved, it's impossible to see the job that was not created.

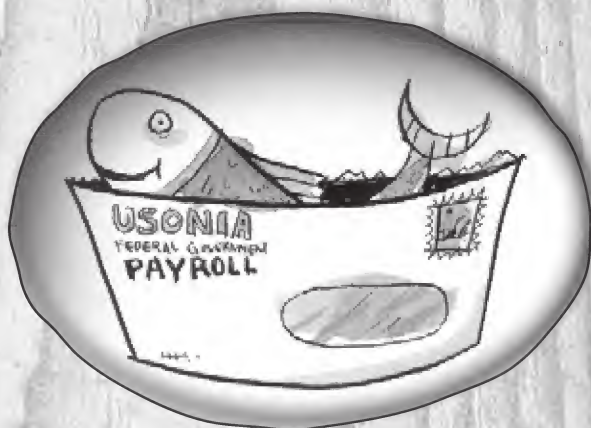
It makes no sense to waste our labor making things that can be produced more efficiently abroad. If we focus on the things that we can make more efficiently than anyone else, then we can trade those products for the things that others produce better. In the end we'll have more stuff.

Of course, the problem is that because of our artificially high currency, high taxes, and restrictive wage and labor laws, we just are not competitive in enough product categories. That has to change.

CHAPTER

8

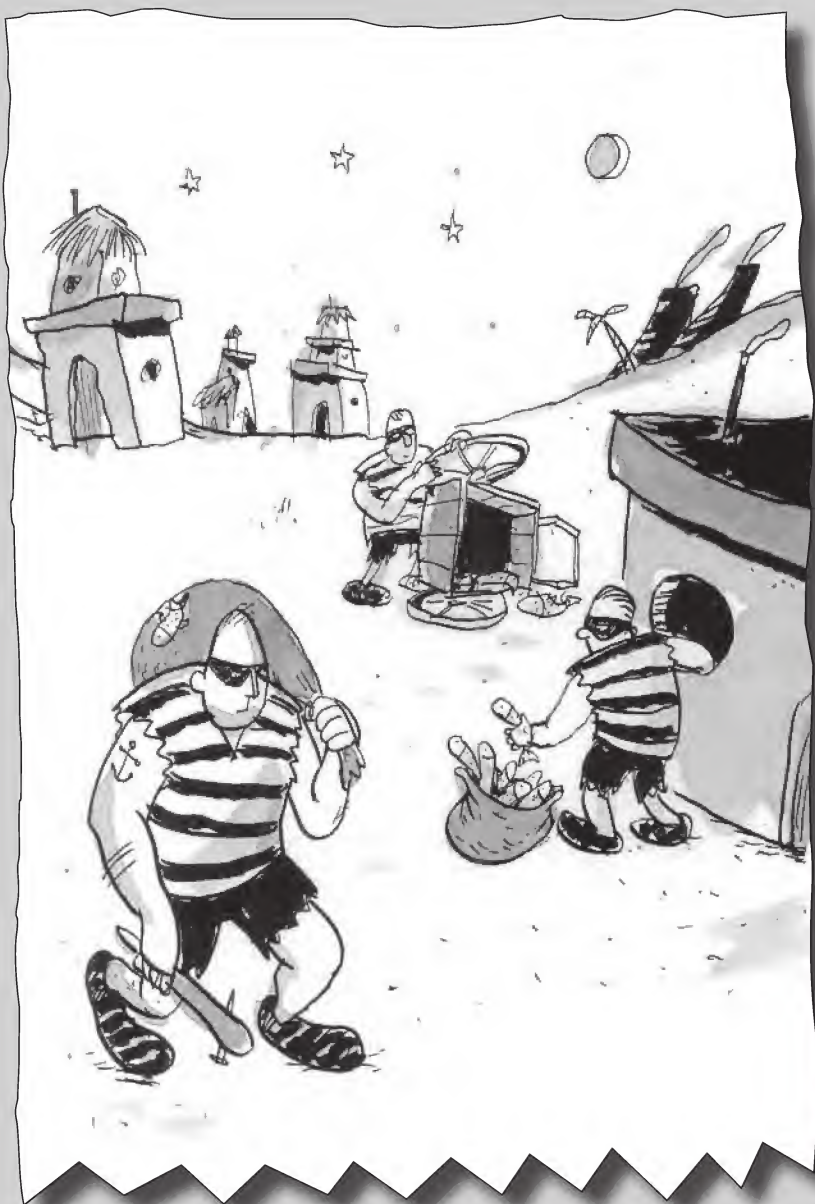
A REPUBLIC IS BORN



In the beginning, the island had no government... compensation at least for the limited diet. Able, Baker and Charlie were old friends and worked out disputes amicably. But as simple societies grow more complex, there inevitably arises the need for some central authority.

With more people on the island, misunderstandings multiplied. When words failed to settle the matter, spears were often employed to bring about a resolution.

With no organized mutual defense apparatus, occasionally gangs of fish filchers would go on a rampage and make life miserable for the islanders.



Every now and then the island would be invaded by the Bongobians, who in addition to being great drummers were also fierce plunderers. When the Bongobians got their mojos working, no saved fish were safe.

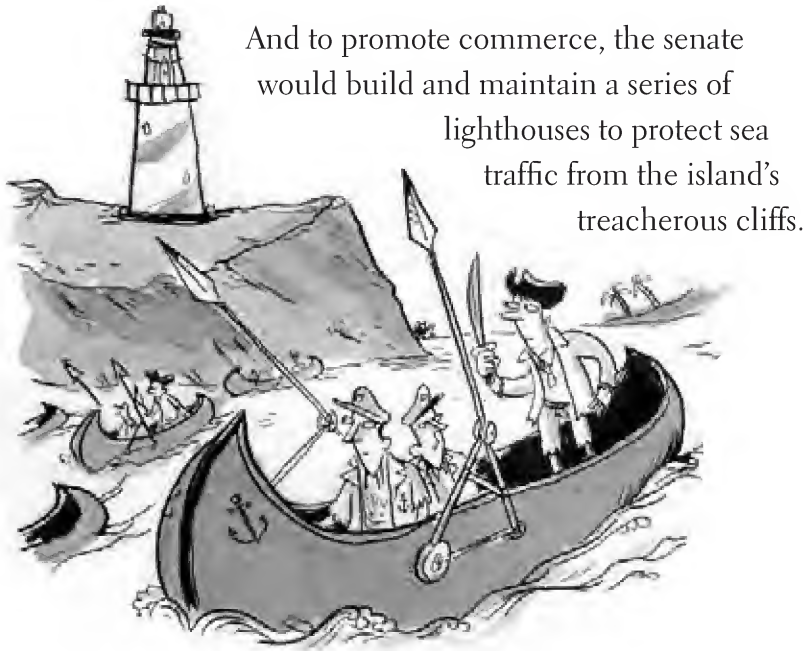


It was evident that the islanders needed to band together for mutual protection and security. They needed some leadership. But handing out power is always a risky business. Once given, power is almost always abused.

After experimenting with a variety of vainglorious chieftains and other losers, the islanders decided to put together a government that would be accountable to the people and would be limited in its ability to take away the freedoms that had brought the island its prosperity in the first place. It was decided that the islanders would elect 12 senators, including a senator-in-chief with executive authority.

To protect the island from hostile invasion, the senate would create and oversee a navy of spear-packing war canoes.

To promote social stability, and to protect every islander's rights to life, liberty, and property, the senate would establish a system of courts to settle disputes, and a police squad to enforce the decrees of the judges.



And to promote commerce, the senate would build and maintain a series of lighthouses to protect sea traffic from the island's treacherous cliffs.

In order to finance this modest apparatus, the islanders agreed to pay a yearly fish tax. All the fish sent in to the government would go into a special government account at the bank. The senate would draw on these funds to meet its expenditures.

But as the island was populated by fiercely independent citizens, many were wary of investing too much power in too few hands.

In order to ensure that the senators did not play fast and loose with the island's fish taxes, a constitution was drafted that clearly authorized certain powers to the senate. Powers not mentioned were reserved to the people alone. Just in case there was any confusion as to what the senate could and could not do, a supreme judge was put in place to enforce the constitution and maintain a check on the political ambitions of senators.



When the constitution was voted on and passed, the island nation was dubbed the Republic of Usonia.

The new government wisely decided to not spend all the fish it raised in taxes. The reserves could come in handy in case an unexpected monsoon temporarily sapped the island's ability to fish or if the Bongobians launched a new and more elaborate raid.

And although the government did keep a number of people on its payroll—lighthouse keepers, constables, judges, and navy paddlers—everyone understood that those jobs could exist only because the government taxed society's producers. If producers didn't send in fish, the government employees couldn't eat.



✓ REALITY CHECK

Because the islanders understood that government spending was really the same as taxpayer spending, they believed that it should be the taxpayers who decided how the money was spent. As a result, voting was restricted to those who paid tax.

It was also understood that taxes reduced the available pool of savings on the island and limited the supply of investment capital. But most island residents agreed that the commercial benefits that flowed from increased island security, fewer canoe wrecks, and a court system that enforced contracts and disputes, more than compensated for the lost savings.

So far, so good. But there's always something...



TAKEAWAY

It's a shame how few modern Americans really understand how our country was founded on a radical experiment in strictly limited government. Steeped in the transformative philosophies of freedom, reason, and science that flourished in the seventeenth and eighteenth centuries, the Founding Fathers sought to create a completely new relationship between people and government, whereby sovereignty rested with the individual, whose rights were inviolable.

In the early days after the War of Independence, in exchange for the establishment of a national government, which many Americans did not want, the U.S. Constitution was conceived as a masterfully designed cage that would prevent the “beast” of government from running amok. The Constitution not only protected people from government, but it also protected minorities from the tyrannies of majorities.

The Constitution deliberately sought to segment powers in the different branches of the federal government to decentralize authority into the many states, and most importantly to prevent the federal government from taking any power it decided to take.

The result was a nation where individuals could be secure in their personal liberty and possessions, and who were not prevented from disposing of their assets in any way they saw fit. The fact that these rights, unfortunately, did not apply to all inhabitants of the new country, does not diminish

the audacity of the idea, which had never previously been codified in any other country.

Over time, that clarity of vision has been blurred. In times of crisis enough people become convinced that government needs more power and that people can get by with fewer liberties. In our current economic crisis, this trend has unfortunately gathered a great deal of steam.

In our desire to make the pain of economic contraction go away, we have forgotten that freedom involves risk. If government is obligated to cure all hardships, then no one is really free in the first place. Take away the freedom to fail and you have obliterated the freedom to succeed.

CHAPTER

9

GOVERNMENT GETS CREATIVE



For many generations the island government functioned as planned. A series of wise and restrained rulers came and went, maintaining a strict focus on encouraging business expansion and personal savings. Taxes were comparatively easy to bear and regulation of industry remained light. As production expanded, businesses profited, prices steadily fell, and purchasing power rose. After a few generations, almost every family owned a canoe. Some families even had two or three.

Since it took only a few dedicated fishermen to provide for the island's entire nutritional needs, labor and capital were freed up for other purposes. New industries and services were developed that had been completely unknown in the days of hand fishing. Hut furnishings, witch doctoring, and drum making companies sprouted and flourished. Things got so prosperous that a theater troupe opened on the island's west coast. The premiere production of *The Fishman Cometh* opened to rave reviews.



Along the way, some senators made the emotional case that the Constitution's original linkage between tax payment and voting eligibility was fundamentally undemocratic. Out of a spirit of progressivism, this restriction was removed, bringing to the polls a great many voters who were far less interested in government budgetary prudence.

As the government payroll grew along with the economy, the job of senator inevitably gained in status and appeal. Originally a position for just the most revered and accomplished of the island's elders, the Senate now began to attract ambitious go-getters.

One of the more innovative of the senatorial hopefuls was Franky Deep, who noticed a strain in human behavior that provided him with a path to power.

He observed that people loved getting stuff for free. Similarly, they hated paying taxes. So, he devised a plan: if he could find a way to make it look like he was giving something to the islanders for free, then he could gain their unconditional support. Unfortunately, all the government had was what it raised in taxes. The Senate didn't catch any fish. They could only give by taking. How could they give more away more than they took?

After a particularly bad monsoon, Franky sensed an opportunity (politicians never let a crisis go to waste).

He preached, "My fellow islanders, the storm we have just been through has wrought untold hardship on our people. Many of our citizens are now hutless and fishless.

We cannot stand idly by and do nothing. If elected, I will institute a government reconstruction program for our neediest citizens to



repair the damage. But he assured the citizens that the cost of the construction would be paid for by the economic activity the spending generated.

His opponent, Grouper Cleveland, offered nothing, except wise stewardship of the island's savings and a promise not to interfere with the liberties of the citizenry.

Not surprisingly, Franky Deep sailed into office as Senator in Chief.

His election victory did not change the fact that there were not enough fish reserves to finance the spending plans he envisioned. To cover the gap, Franky came up with another plan. The government would issue paper money called Fish

Reserve Notes, which would be redeemable for actual government fish stored at the Goodbank.

Citizens could get their fish immediately

or use the notes to trade for other goods and services just as they would

have done with real fish.



Disgusted, the island's chief judge weighed in, and pointed out that the Constitution gave the Senate no authority to take money from one citizen for the sole benefit of another, nor did it have the authority to issue paper notes for fish.

Franky solved that problem by nominating one of his political buddies to sit as judge. The more cooperative jurist declared the Constitution to be a "living document" whose precepts could be actively interpreted by new generations confronting issues unforeseen by the founding fishers.

At first, the citizens were a little uncomfortable with the new Fish Reserve Notes. They were used to paying for things with actual fish. But after a while the new paper notes caught on. Most had to admit that they were easier to carry and the odor was a distinct improvement.

Meanwhile,
Franky's advisors
scoured the
island looking
for worthy
projects to fund
(maintaining
unvarnished
objectivity, of
course). When
they found
a project that
would be guaranteed to have enough support from potential
voters, they handed out the new notes to make it happen.



The new bank director, Max Goodbank VII, was not crazy about the new fish notes. He thought the ease in which the notes could be printed would create dangerous incentives for the senators. Yet, he could sleep soundly at night provided that the government maintained enough actual government fish in the bank to redeem all the notes.

Not surprisingly, his confidence didn't last long.

Soon, Franky and his agents had handed out far more Fish Reserve Notes than the government's account had fish to redeem. When Max Goodbank noticed the dwindling reserves, he headed to the Senate to sound the alarm.



"Franky, stop the presses!" shouted

Max. "I have only nine fish available for every 10 notes that you guys have handed out. If the savers figure out that there really aren't enough fish to cover their deposits, there will be a run on the bank and I'll be out of fish. You have to stop issuing Fish Reserve Notes and raise taxes. We've got to replace our reserves."



Franky and his top advisors, Hughey Humpback and Tad Anemone, burst out laughing. “Raise taxes and cut spending...that’s a good one! You’d be a real force on the campaign trail! Got any other bright ideas?”

Goodbank explained, “Sorry, guys, but there really is no choice. Once the savers on the island realize that there is really no safety in bank deposits, they’ll stop saving! They’ll keep their fish at home like they used to. There will be no pool of capital available to maintain the equipment we now rely on, much less to fund new projects! Our whole economy could collapse!”

“Listen, worrywart,” said Franky. “We thought of that, and we have a plan. Why should the savers have to know that their savings are shrinking and not growing?”

Franky explained, “My economic advisors have degrees from our new University, where they mingled with some of the island’s top scientists. It’s amazing the things that some of these guys come up with. And they have really hit the jackpot. It’s time that we let you in on a little secret. Bring in the technicians.”



At that a number of lab-coated scientists walked in with three regular-looking fish. “Look!” said one. “We’ve been scouring the beaches and garbage dumps collecting discarded fish skins and skeletons...especially the ones with head and tail intact. Just watch the magic.”

Then in a blur of cutting, splicing, gluing, and sewing, the technicians took the fish and began construction of a new fish around the discarded fish parts. They sculpted, molded, glued, and sealed. Using this process they were able to produce four passable fish out of the three. What was once garbage now looked like a genuine fish!

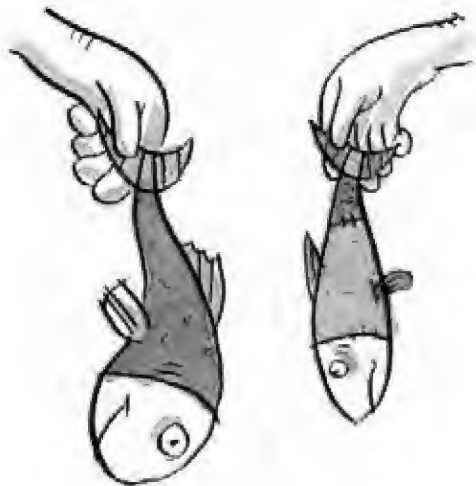
“The secret is in the glue,” said Franky. “This new sealant never comes undone. The fish will hold together indefinitely, and the dupes...I mean citizens...will be none the wiser. We’ll call these new fish ‘official fish’ and we’ll use them to pay back the depositors. Let our boys into your vault for few days and your fish crunch problems will be solved!”

Goodbank was stunned. He had to admit that the trickery was impressive. The corners of his mouth crept up in a smile. He was tired of having to say “no” all the time. It was no fun. Nobody liked him...they called him a tightwad behind his back.

“Maybe this is the way out,” he thought. “Maybe this is a ticket to popularity. First I get the fish...then I get the power...then I get the women!”

But then his good sense rushed back. “These people aren’t magicians,” he thought. “Fish don’t grow on trees! All the senators can do is create fake fish by diminishing the value of the island’s savings!” He tried to reason with them.

“Come on, the depositors will get wise. Look, your ‘official fish’ looks skimpy next to a genuine fish! After all, people have been eating fish a long time around here. Everyone knows the value of a fish. They may not be that easy to fool.”



Answering in his most diplomatic voice, Franky tried to calm Goodbank's fears. "We thought of that. So for a start, 'official fish' won't need to be too much smaller. We'll make 10 official ones out of every nine real ones, so they'll be only 10% smaller. In addition—and this is the genius part—we'll pass a law to prevent islanders from comparing them to real fish!"



Tad Anemone chimed in, "Yes, that's right. We'll say our scientists have discovered a new disease among unprocessed fish, and we'll require everyone to turn in their genuine fish for officially decontaminated fish as soon as they are caught!"

The senators and technicians described how the decontamination process would explain why “official fish” were not quite as filling.

To keep people from seeing real fish themselves, and to supposedly increase fish production, the senators also decided to establish a Fishing Department, which would have sole responsibility for catching fish.

Goodbank could take no more of this. “This can’t work! If people stop fishing for themselves and rely on the government instead, our total catch will diminish. Eventually we will run out of savings.”

“How can you be so sure?” countered Franky. “Our Fishing Department will be the wave of the future. We’ll put in only our most trusted friends as managers, and we’ll give special prizes to the workers who show the greatest civic spirit. And besides, we only need to keep it going through the next election. After that we’ll think up a more long-term plan.... I promise we will.”

“In the meantime,” said Hughey Humpback, “this new fish expansion procedure will give you enough fish to cover all of your outstanding obligations and pay all the interest on your deposits. We will even have fish left over to spend in ways that will finally do some good for our people!”

Goodbank thought about it some more. “It can’t work. The people will get wise. They will worry about their savings and withdraw their deposits.”

“We’ve got that covered,” explained Franky. “We will declare that all deposits will be guaranteed by a new government agency called the Fish Deposit Insurance Corporation (FDIC for short). Once people know that the senate stands behind their deposits, who’s going to withdraw their fish? With insurance in place, depositors will think that we are protecting their savings even while we loot its value.”

“So, Max,” said Franky, leaning in close and giving him a squeeze around the shoulders. “You’ll go along, won’t you?”

Goodbank was tempted to throw his lot in with the reformers, but he found his spine. While the politicians were worried about the appearance of solvency, and their own heroic self-images, he was concerned about the value of the fish.



“Absolutely NOT!” he thundered. “It’s fraud...deception! If there’s one trait you senators have in common, it’s dishonesty! I’ll close the bank and tell the people to save their fish at home before I go along with this.”

During this tirade the senators rolled their eyes and shrugged their shoulders, and eventually they could take no more. Franky summoned the Senate guards. He whispered a few words to the chief guard, and Goodbank was hauled away kicking and screaming...his parting words falling on deaf ears.



“It’s too bad that chump wouldn’t play ball,” said Franky. “Get Ally Greenfin in here!”

Franky then appointed Greenfin as the new director of the bank with strict instructions to implement the fish expansion plan at full tilt. Furthermore, the Goodbank Savings and Loans would now be called the Fish Reserve Bank.



The next morning the body of Max Goodbank VII, the island's trusted banker, was found tangled in the coral reef. The death was attributed to natural causes. Eulogies, bathed in crocodile tears, echoed from the highest halls on the island. Senator Franky ordered a lavish funeral.



With Ally Greenfin now chairman of the Fish Reserve Bank, the scheme worked to perfection. The transition from genuine fish to “official fish” was made....



TAKEAWAY

As discussed earlier, the United States experienced sustained deflation for most of its history. Then in 1913, the Federal Reserve was established. The notes it issued, which promised to pay the bearer gold on demand, replaced the private bank notes then in circulation, which offered similar guarantees. But as soon as the Fed came on the scene, prices started rising steadily.

The Fed, as the Federal Reserve is known, was originally given the mission of establishing an “elastic money supply.” The idea would be that the Fed could expand or contract the amount of money in circulation to correspond with economic activity. It was thought that such movements could hold prices steady through good times and bad.

Even if such a mission were a good idea to begin with, it’s easy to see that the Fed has utterly failed in accomplishing it.

Over the past 100 years, the dollar has lost more than 95 percent of its value. So much for price stability! The truth is that the Fed now exists for the sole purpose of providing the inflation necessary to allow the government to spend more than it collects in taxes.

During the Depression, President Roosevelt decided to devalue the dollar against gold. In order to pull this off, the government had to control the entire gold market, and for a time the government made it illegal to own gold coins. Later on the ability to redeem the notes for gold was restricted to just banks, then to just foreign banks, and then finally to no one.

We are left with a currency that has no real value and can be expanded at will. This has prevented the government from ever having to make hard choices about spending and taxes, and has set us on a path that will eventually destroy the remaining value of the dollar.

CHAPTER
10
SHRINKING
FISH



The senators could not believe their good fortune. They could now make campaign promises and spend at will! There was no reason to balance the budget or raise taxes to pay for the spending.

So every year the government issued more Fish Reserve Notes than the bank had savings to redeem. When the deposits got low, the fish technicians worked their magic. The mix proved to be intoxicating. And despite their gnawing urge to contain the situation, and to get back to a sustainable path, the senators just couldn't help themselves.

Some of the projects funded by government provided some benefit to all. The island navy got bigger canoes, which kept the Bongobians at bay; and a new system of cart paths made transportation easier. However, the benefits provided by the controversial Clean Rocks Jobs Program were much harder to quantify. But whether shiny rocks were something the island actually needed did not diminish the program's popularity to those who got the jobs.

Meanwhile the new government Fishing Department got up and running. By offering generous benefits and salaries, the department easily hired workers. Those who got the jobs loved the steady work, and happily voted for their senatorial patrons.

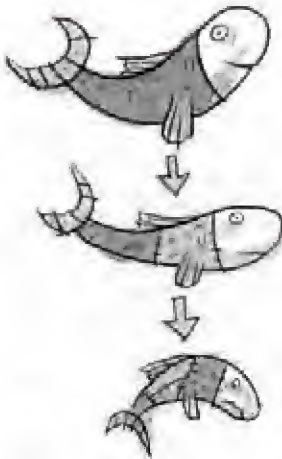
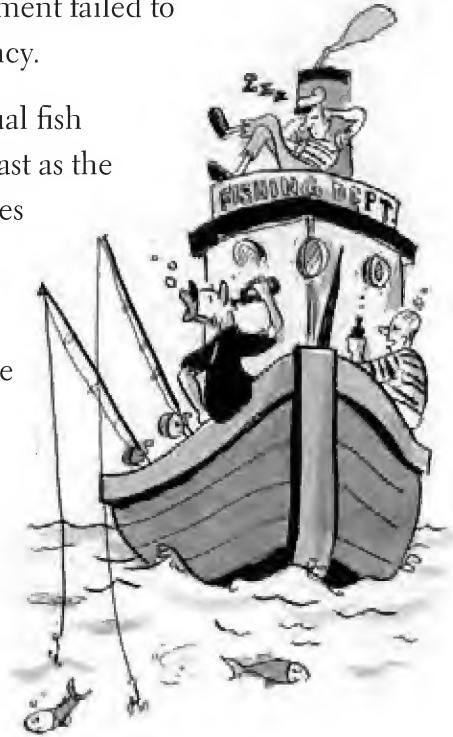


But beneath the surface, there were real problems brewing.

With no personal incentives to take risks and make profits, the Fishing Department failed to become a model of efficiency.

The rate of increase of actual fish production did not rise as fast as the supply of Fish Reserve Notes that the Senate put into circulation.

Soon so many Fish Reserve Notes had been issued that the technicians had to increase the conversion rate. Ten to nine gave way to five to four. This meant that official fish were now 20 percent smaller than real fish.



When that proved insufficient, the conversion dropped to three to two, and eventually two to one.

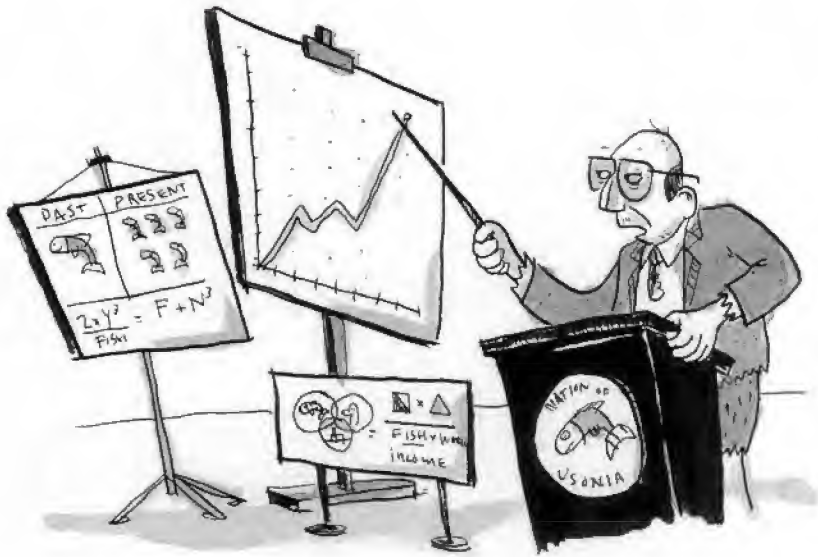
As official fish became smaller and smaller, it soon became apparent that the islanders could no longer survive on just one fish per day. Most now ate two per day, at minimum.

Given that fish were used as money on the island, prices for everything had to go up to keep pace with the diminished nutritional value of fish. The nagging problem of “fishflation” was born. So while efficiency had traditionally driven prices down, now government-created fishflation forced them in the opposite direction.



Strangely, no one could agree on why prices were going up. Ally Greenfin offered a needed theory. “Fishflation,” he said, “is caused by a phenomenon known as the ‘cost-price-fish push.’” He argued that high employment (thanks in part to government jobs) combined with a strong economy creates greater demand for fish and forces up prices.

As proof of their prosperity Greenfin noted that most islanders were now eating twice as many fish as their parents.



Greenfin warned that without the stimulus that is provided by a steady dose of fishflation, people would lose their appetites, and stop demanding fish, and the island economy would contract. He further theorized that a fishflation level of only one-half of a fish belly per year would be optimal. Fishflation, he argued, was essential to an expanding economy!

“Nice figuring, Ally. You could talk a shark out of a fish barrel,” said Franky. But nobody thought of pointing a finger at government, the real cause of fishflation!

With a blank check to do whatever it wanted, the government continued to curry favor with citizens by issuing more and more Fish Reserve Notes. As it did, the official fish continued to shrink in size and the fish became less and less valuable. Wages and prices, therefore, had to go up. Although in some years the fishflation was barely noticeable because of offsetting

productivity gains, two things were certain: the fish never got bigger, and prices rarely went down!

When fishflation became rapid, islanders finally noticed that the fish they withdrew from the bank were smaller than the fish they deposited. So, despite the enticement of interest paid on their savings, they began to save less while many discontinued saving completely. Instead, fish had to be spent quickly to avoid losses due to rapidly increasing prices.

The real burden of this rapid fishflation fell on retirees. Those who had deposited fish in the bank during their working years found that they had to eat two or three fish per day just to survive. The savings that they had hoped would last for 20 years, were gone in just four or five.

Since fishflation discouraged saving, bank deposits dwindled. As a result, there were less fish available to fund promising projects or prop up sagging businesses. In response, businesses cut back and workers were laid off. Desperate to offset the effects of fishflation, many more islanders decided to risk thier savings with Manny Fund, whose promise of oversized returns gave investors the best hope of overcoming these losses.

When unemployment reached a crisis level, people demanded that the government do something.

In response, the Senate set strict limits on how much companies could pay workers, under what circumstances the workers could be hired and fired, and how much the businesses could charge for their products. The resulting